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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. [redacted] 110

W. E. RICHARDSON, IN HIS OWN RIGHT AND AS TRUSTEE, AND OTHERS,

Petitioners,

vs.

BLUE GRASS MINING COMPANY AND OTHERS.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

BAILEY P. WOOTTON,
WM. ERNEST FAULKNER,
A. B. BOWMAN,
J. R. SIMMONDS,
Counsel for Petitioners.

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SUPREME COURT OF THE UNITED STATES

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No. 1274

W. E. RICHARDSON, IN HIS OWN RIGHT AND AS TRUSTEE, AND OTHERS,

Petitioners,

vs.

BLUE GRASS MINING COMPANY AND OTHERS.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

To the Honorable Supreme Court of the United States:

This suit is prosecuted by petitioners alleging themselves to be stockholders of Blue Grass Mining Company and Pendleton Store, Inc., against the corporations and their managing and controlling officers, directors and stockholders, for an accounting on behalf of the corporation, and all stockholders, of funds allegedly taken, converted and used by such managing and controlling individuals, and for the recovery of property acquired by them in their own names with corporate funds.

Another aspect of the suit was to establish the quantum of petitioners' holdings in said corporations. From the action of the Trial Court decreeing petitioners a 50% interest in the corporations and awarding judgment on certain items of accounting, respondents appealed to the Circuit Court of Appeals, and from the action of the Trial Court in denying petitioners' claims on certain items of accounting including those herein mentioned, petitioners took a cross-appeal.

Opinion of the District Court rendered October 17, 1939, is published in 29 Fed. Supp. p. 658, and appears in the record Vol. I, at p. 358, the findings of fact in R. I. p. 385, and decree entered August 1, 1940, in R. I. p. 417.

The Court of Appeals affirmed, March 2, 1942, (R. VI. p. 2183).

I.

Summary of the Matters Involved.

Certain individual defendants, J. E. Johnson, Sr., J. E. Johnson, Jr., Wm. Pendleton and Arch Pendleton (known in the record as the "Kentucky Group"), undertook to appropriate to themselves all of the capital stock of two Kentucky corporations, Blue Grass Mining Company and Pendleton Store, Inc., notwithstanding the right of petitioners (since adjudicated below) to one-half thereof, and proceeded to elect themselves directors and officers of said corporations, and assumed and exercised sole and exclusive management and control thereof, voting to themselves large salaries or bonuses, lending to themselves or to other corporations owned and controlled by them, large sums of money, and financing and promoting new enterprises and corporations with the corporate funds, taking title in their own names to property bought with corporate funds, and doing various other acts to their own interest and to the detriment of the interests of the corporations. The ques-

tion involved is whether or not managing and controlling directors and officials of corporations guilty of such fraudulent conduct will be denied all compensations for acting in their trust capacity, and be required to disgorge the stock of corporations promoted by them with the trust funds, all as insisted by petitioners, or whether they may, in equity, be allowed "reasonable" compensation for their services, and permitted to keep at least a part of the fruits of their illicit investments, as held by the lower courts.

We submit that substantially every material fact to support petitioners' insistence under the law, was found by the Trial Court and approved by the Circuit Court of Appeals, and we therefore shall not question the findings of facts, but shall rely thereupon in support of this petition. Since the facts are fully found by the Trial Court, concurred in on appeal and not now challenged (See Opinion, 29 Fed. Supp. 658; R. I. p. 358, and Findings of Fact R. I. p. 385), it would seem to be necessary here only to epitomize said opinion and findings in so far as material to the issue here raised.

II.

Statement of the Case.

So far as necessary to a consideration of the questions here involved the facts may be stated as follows:

In December, 1929, the Kentucky group acting in the name of J. E. Johnson, Sr., entered into a contract with the petitioners, known in the record as the "Tennessee Group", acting then in the name of M. T. McArthur, Trustee (later succeeded by W. E. Richardson, Trustee), under which the Tennessee Group acquired a 50% interest in a bid then pending and unconfirmed, on a certain coal mine and equipment, and a certain commissary stock of merchandise and fixtures, in the State of Kentucky, and also

under which the two groups were to join in the formation of two corporations to operate said properties and venture and to receive the titles, each group to own 50% of the stock of the corporations (R. I. 53). The bid was confirmed in the court in which the sale was ordered and the corporations were chartered, the members of each group subscribing to 50% of the stock (R. II, pp. 1-12; 44-46; 218-19; 320-21; R. III, pp. 762-65). The Tennessee Group put up their share of agreed working capital (R. II, 82; 320-23). However, no certificates of stock in the corporations were ever issued. The corporations went into possession of the properties and immediately began successful operations. The Kentucky Group, two of whom, J. E. Johnson, Sr., and J. E. Johnson, Jr., were lawyers, held the organization meetings of the corporations in December 1929, and January 1930, and unknown to the Tennessee Group, attempted to allocate the entire capital stock to themselves, in violation of the subscription agreements, and elected themselves sole directors and officers, without furnishing any minutes or records of the meeting to the Tennessee Group, or giving them any information other than that an organization meeting had been held (R. II, pp. 4-6; 80-81; R. VI, pp. 1812-20). In the summer of the year 1930, the Kentucky Group again unknown to petitioners, purported to pay for this stock by entry of accounts on the books in their favor as alleged salaries and charging these with alleged payments for stock. The original sale of the coal properties was reversed on appeal in May, 1930, but the corporation remained in possession under an interim lease with the receiver, and at the second sale held in the autumn of 1930, the coal properties were purchased for the Blue Grass Mining Company, which paid for them after the second bid and sale was affirmed on appeal. The original sale of the commissary stock of merchandise and fixtures was never reversed.

In February, 1931, the Tennessee Group were induced by fraudulent representations of the Kentucky Group, to sign, through their representative, W. E. Richardson, Trustee, a purported agreement the effect of which would have been to reduce their stock interest in the corporations from 50% to 30% (Findings of Fact 22-23, R. I, p. 391).

The Tennessee Group kept in touch in a general way with the enterprise, but were not furnished statements, and knew nothing of the financial matters. Repeated requests to the Kentucky Group by the Tennessee Group to issue the stock of the corporations be[illegible]vaded, the Tennessee Group demanded an audit, which, though at first resisted, was finally made in 1935. This audit revealed that the Kentucky Group had consistently used the funds of the corporations to promote their own interests and affairs, some of which had been paid back with interest, most of it without interest, and some not at all; that they had by the aid of corporate funds acquired property in their own names adverse to the interests of the corporation, and that they had withdrawn under the guise of salaries to themselves, practically the entire corporate earnings (R. I, p. 390).

At the first and only stockholders meeting ever called and held on February 8, 1936, the Tennessee Group complained that their entry into the alleged contract of February 18, 1931, reducing their stock interest to 30% in the corporations had been fraudulently induced, and demanded to participate as owners of 50% of the stock. The Kentucky Group demanded that they participate as owners of 30% of the stock or leave the meeting. The Tennessee Group did the latter, and filed this suit on the theory that they were the undisputed owners of 30% of the stock of the two corporations, and claiming to be the rightful owners of 50% of the stock, and also seeking an accounting on behalf of the corporations and all stockholders, with the

Kentucky Group constituting their officers and directors (R. I, pp. 1-53, 137, 144, 152, 182, 255, 326, 332, 391-2). The Kentucky Group answered for themselves and the corporations denying that petitioners, the Tennessee Group, were entitled to the ownership of any of the stock of either of the corporations, or were entitled to an accounting (R. I, pp. 102, 157, 164, 211, 285, 339, 348).

Among other illegal acts the Kentucky Group loaned to themselves, or to a corporation organized by them, labor, material, and money to the extent of thousands of dollars to start another coal mining operation under the name of Black Gold Mining Company, on lands adjoining Blue Grass Mining Company properties, mining the same seams of coal, and entering a competitive market with Blue Grass coals. The Kentucky Group put little, if any money into this proposition, though they borrowed some money for it, to be repaid on a per ton basis, which together with Blue Grass Mining Company money, financed it. This Black Gold Mine proved a profitable enterprise from the beginning, and members of the Kentucky group repaid the money which they borrowed for it from its earnings, and drew large sums as salaries therefrom at the same time they were drawing large sums from Blue Grass Mining Company and Pendleton Store, Inc., under the guise of salaries (R. I, pp. 399-400).

Had the Kentucky Group been working in the interest of Blue Grass Mining Company instead of their own interest, this Black Gold property would have been acquired in its name instead of theirs. The properties adjoin the Blue Grass properties and carry the same seam of coal (R. III, pp. 616-17). The coal is sold in the same market and office, buying and selling facilities are shared (R. III, p. 753; R. IV, pp. 1098-9, 1203-6; R. V, pp. 1523-27). They have a common executive and supervisory management and are operated practically as one property, except the profits

go to different sources. The property would have been advantageous to Blue Grass, respondent Johnson, Sr., testifying that one reason for its organization was that Blue Grass needed additional tonnage for efficient conduct of its sales facilities (R. VI, p. 1749).

The Kentucky Group were guilty of many other acts of misconduct and breach of trust, too numerous to mention here.

In that phase of their suit on behalf of the corporations and all stockholders, against said Kentucky Group, petitioners, among other things sued (1) to compel the members of the Kentucky Group as recreant trustees, to refund to the treasuries of the Blue Grass Mining Company and Pendleton Store, Inc., the funds withdrawn by them as alleged salaries, and (2) to require them to issue to Blue Grass Mining Company the stock of Black Gold Mining Company, and its subsidiary holding company, Jeda Coal Company, because said last named corporations had been financed with Blue Grass Mining Company funds.

The first of these prayers was granted in part, the trial court requiring a part of the so-called salaries to be refunded to the corporate treasuries, that although the members of the Kentucky Group would be required to make restitution for their fraudulent breach of trust, they would not be penalized by denial of compensation, and would be allowed reasonable salaries. As to the second proposition, the trial court held that, although the use of the trust funds by the Kentucky Group in promoting Black Gold Mining Company was wrong and indefensible, the money was repaid and the Company sustained no loss, and, therefore, the Kentucky Group should be allowed to keep this property and the salaries they had drawn therefrom (R. 339-400).

See *W. E. Richardson* v. *Blue Grass Min. Co., et al.*, 29 Fed. Supp. 658 (R. I, p. 358).

The Circuit Court of Appeals affirmed the decree of the District Court, without opinion (R. VI, p. 2183).

III.

Findings and Decree of Courts Below.

The action of the District Court, affirmed by the Court of Appeals, which forms the basis of petitioners' complaint here, may best be illustrated and most succinctly presented by the two quotations following from the findings of fact and conclusions of law by the learned trial Judge, pursuant to which decree was entered, to-wit:

> "While the members of the Kentucky group have been guilty of fraudulent breach of trust in using the funds of the affiliated corporations to finance various corporations and enterprises organized or promoted by them, in the purchase of property necessary or advantageous to the corporations for their personal gain and enrichment, in denying to Blue Grass Mining Company title to properties purchased by or for it and paid for by it, in attempting to appropriate to themselves all the capital stock of Blue Grass Mining Company, Pendleton Store, Inc., and Blue Grass Coal Company, and in attempting to exclude complainants as rightful and bona fide stockholders of Blue Grass Mining Company and Pendleton Store, from all interest in or benefit of the corporations and their assets, and in other questionable transactions, for these derelictions the Court will require full restitution, and equity does not demand that they be denied reasonable compensation for their services. There is room for judicial discretion. I conclude therefore, that reasonable compensation for services of the Kentucky group for the period ending March 1, 1937, would be: J. E. Johnson, Sr., $5000.00 per annum, or a total of $35,833.32; William Pendleton $4,800.00 per annum, or a total of $34,400.00; J. E. Johnson, Jr., $2,400.00 per annum, or a total of $17,200.00; Arch Pendleton $3,000.00 per annum, or a total of $21,500.00." (R. I, p. 416.)

"With the aid of funds and credits advanced by Blue Grass, Black Gold became an operating company and began shipping coal in January or February, 1931, before any funds were put into it by its organizers and stockholders in March and April, 1931. From the operation of the business of Black Gold and Jeda Companies, J. E. Johnson, Sr., J. E. Johnson, Jr., and Wm. Pendleton, received substantial annual salaries. Such use of the assets of Blue Grass Mining Company was clearly wrong and indefensible, but the evidence shows that for all services rendered and credit extended to Jeda and Black Gold, Blue Grass Mining Company has been fully paid and that all loans or advancements made have been repaid with interest. While it is true that the aid received from Blue Grass Mining Company was a substantial advantage to the Kentucky group in promoting their interests in Black Gold and Jeda, the claim that these corporations were financed entirely by Blue Grass Mining Company is not sustained by the evidence. Blue Grass Mining Company appears to have suffered no actual loss on account of any of these transactions." (R. I, p. 400.)

Other findings are pertinent, but the above quotations present the issue clearly and in the shortest possible space.

IV.

Jurisdiction and Reasons for Invoking.

Jurisdiction of this Court is invoked under U. S. Code Annotated, Title 28, Section 347, as amended by the Act of February 13, 1925, C. 226, Sec. 1, 43 Stat. 938; Jan. 31, 1928, C. 14, Sec. 1, 45 Stat 54; June 7, 1934, C. 426, 48 Stat. 926, Rule 38 Sub. Sec. 5(b), and Sec. 34 Judiciary Act of Sept. 24, 1789, Ch. 20, U. S. C. A. 725, and *Erie R. Co.* v. *Thompkins*, 304 U. S. 64, 82 L. Ed. 1188.

The reasons for invoking the jurisdiction of this Court are three fold.

First: That the common law of Kentucky concerning compensation of trustees, as determined by the highest court of that state, may be applied.

Second: That there may not result from the opinion of the District Court (29 Fed. Supp. 658), and decree thereon, and from the decree of the Circuit Court of Appeals affirming same, any confusion in or modification of the repeated decisions of other Circuit Courts of Appeals, and of this Court to the effect that a Trustee found guilty of wilful and fraudulent breach of his trust will not be allowed compensation or be permitted to keep the gains from his fraudulent manipulation of the trust funds.

Third: that there may be no deviation from or weakening of the rule, repeatedly announced by this and other courts, that one who gains through the wilful and fraudulent misuse of trust money and property will be required to disgorge his illegal gains and be penalized by denial of compensation. This rule is so fundamental to business and civic morality and to the preservation of society itself, that its slightest relaxation, even in matters of private enterprise, must be charged with a public interest.

V.

Questions for Decision.

We, therefore, present to this Court for decision but two questions, to-wit:

(1) Whether or not managing and controlling directors and officers of a Kentucky corporation, administering their trust in Kentucky, who are found to be guilty of wilful and fraudulent breach of trust imposed upon them by law as such, and who finally denounce their trust and seek to appropriate to themselves the entire trust estate, are entitled to any compensation, under the applicable law

of Kentucky, or the law as announced by this Court and the courts of other Circuits.

(2) Whether or not officers of a corporation who have used the funds and credit of the corporation to acquire other property, the ownership of which would be advantageous to the corporation, and have wilfully and wrongfully used the credit of the corporation to promote and organize corporations for the exploitation of the property so acquired, are entitled to the ownership of the property so acquired, and the stock in the corporations so organized, as between them and the parent corporation so entrusted to them.

VI.

Probable Errors.

We submit that the Courts below probably erred in the application of the law to the facts as found. According to the opinion and findings of the learned trial Judge, equitable principles had to be called in to extricate the guilty trustees from the position in which their misconduct has placed them. Equity is a protection for the innocent and should never be a shield for the wrongdoer. Therefore, the probable errors consist in

(1) Failure to give effect to the applicable Kentucky law as to compensation for trustees guilty of wilful and fraudulent breach of trust.

(2) Allowing "reasonable" or any compensation to trustees guilty of wilful fraudulent misconduct, and who attempt to appropriate to themselves the entire property entrusted to them, and who, in the final accounting, denounce their trust.

(3) In allowing such trustees to hold property acquired by the use of trust funds, which property would be advan-

tageous to the trust estate or would be harmful in the hands of strangers to the trust estate.

(4) In resorting to the aid of equity to extricate the wrongdoers from the difficulties in which they had placed themselves.

WHEREFORE your petitioners respectfully pray that a writ of certiorari issue out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, Sixth Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket Blue Grass Mining Company et als., Appellants and Cross-Appellees, v. W. E. Richardson, Trustee, etc., et als., Appellees and Cross-Appellants, numbers 8870-8871; that the judgment of the said Circuit Court of Appeals may be reversed by this Honorable Court, and that petitioners may have such other and further relief in the premises as may seem meet and just. And Petitioners will ever pray.

W. E. RICHARDSON, Trustee, etc., et als.,
Cross-Appellants, *Petitioners,*
By BAILEY P. WOOTTON,
WM. ERNEST FAULKNER,
A. B. BOWMAN,
J. R. SIMMONDS,
Their Attorneys.

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Counsel for Petitioners.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1274

W. E. RICHARDSON, TRUSTEE, ETC., ET ALS.,
Petitioners,

vs.

BLUE GRASS MINING COMPANY, ET ALS.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinion of Lower Court.

The Circuit Court of Appeals wrote no opinion in the case, but merely entered a decree (R. VI, p. 2183), reciting that, for the reasons set forth in the opinion of the District Court, the cause, on both respondents' original appeal and petitioners' cross-appeal, was affirmed. The opinion of the District Court is published (29 Fed. Supp. 658), and will be found in the record, Vol. I, p. 358. The Court of Appeals affirmed without opinion.

II.

Findings of Fact in the Lower Courts Relied Upon.

The findings of fact and conclusions of law by the District Court, affirmed in the Court of Appeals, will be found in the Record, Vol. I, at pp. 385-417.

III.

Statement of the Case.

We adopt the statement contained in the petition for certiorari, though some additional facts may be brought to the attention of the Court in brief and argument.

IV.

Probable Errors and Questions Presented.

The probable errors and questions presented for decision are fully set out in the petition for certiorari and need not be repeated.

V.

Jurisdiction.

We rely upon the Act of March 3, 1891, 26 Stat. 828, as amended and codified in U. S. C. A., Title 28, Sec. 347, and Rule 38 of this Court, especially Section 5, sub-section (b) thereof, which provides for allowance of the writ.

> "Where a Circuit Court of Appeals has rendered a decision in conflict with another Circuit Court of Appeals on the same matter, or has decided an important question of local law in a way probably in conflict with applicable local decisions * * *".

It is submitted that the Circuit Court of Appeals, Sixth Circuit, has rendered a decision:

(1) Probably in conflict with the decisions of other Circuits and of this Court;

(2) of an important question of local law probably in conflict with applicable local decisions, and

(3) On an important question of general law in a way probably untenable and in conflict with the weight of authority.

IV.

BRIEF AND ARGUMENT.

By applicable decisions of Kentucky, as well as by the weight of authority of other circuits and of this Court, trustees guilty of wilful fraudulent breach of trust, and who denounce their trust and seek to appropriate the trust estate to themselves, should be denied all compensation for services.

In *Erie Railroad* v. *Tompkins*, 304 U. S. 64, this Court held that, except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the State, whether it be declared by legislative enactment or by its highest court in a decision.

304 U. S. 78.

The case at bar is of such local character. The corporations of which respondents were officers and directors, were Kentucky corporations; their properties were situated and their business transacted, in Kentucky; the contracts upon which petitioners' rights rest, were to be performed in Kentucky; the trust was being administered by respondents in Kentucky, and the cause of action arose there. Federal jurisdiction rests alone upon diversity of citizenship. The controlling law and public policy of Kentucky has been announced by the highest court of that State.

Cominger v. *Louisville Trust Co.*, 128 Ky. 697, 108 S. W. 950, 111 S. W. 681, 129 Am. St. Rep. 322.

We submit this case declares the law of Kentucky to be that "a trustee guilty of fraud or misconduct in the management of the estate is not entitled to compensation", certainly if such misconduct is found as it was in the case at bar, to be grounded in bad faith.

Again in *Weakly* v. *Meriweather,* 156 Ky. 304, 160 S. W. 1054, the rule was applied, though the trustee was not convicted of bad faith. The Court in the latter case, however, might have been influenced by the fact that little service was rendered by the trustee, who had commingled trust funds with his own, other than payment of interest.

The common law of Virginia, from whose territory the State of Kentucky was carved, seems to have been declared to the same effect.

Boyd v. *Boyd,* 3 Grath, 113;
Ward v. *Funston,* 86 Va. 359, 10 S. E. 415.

This latter may not be material, except insofar as it discloses a settled policy of these people of a common stock who at one time acknowledged a common independent sovereignty.

But if the question be treated as one of general law, rather than one of local law, the decision below is probably untenable and contrary to the weight of authority, including decisions of this Court and the Courts of other circuits.

Walker v. *Beal,* 9 Wall. 743, 19 L. Ed. 814-20;
Barney v. *Saunders, et al.,* 16 Howard 535, 14 L. Ed. 1047, 1050;
Wadsworth v. *Adams,* 138 U. S. 380, 34 L. Ed. 984;
Lewis v. *Ingram* (C. C. A. 10th), 57 F. (2d) 463-465, certiorari denied 287 U. S. 614, 77 L. Ed. 533;
Munro v. *Smith* (C. C. A. 1st), 259 Fed. 1;
Flint River Pecan Co. v. *Fry* (C. C. A. 5th), 39 F. (2d) 457;
Backus v. *Finklestein* (C. D. Minn.), 23 F. (2d) 357, appeal discontinued by stipulation 31 F. (2d) 1011;
In Re Polansky (D. C. S. D. N. Y.), 41 F. (2d) 547;
Caldwell v. *Hicks* (D. C. S. D. Ga.), 15 Fed. Supp. 46;
Davis v. *Swedish Am. Nat. Bank,* 78 Minn. 408, 80 N. W. 953, 81 N. W. 210, 79 A. S. R. 400;

In Re Hodges Estate, 66 Vermont 70, 44 A. S. R. 820;
In Re Kline, 280 Pa. St. 41, 124 Atl. 280, 32 A. L. R. 926;
Turner v. *Ryan* (Iowa), 272 N. Co. 60, 110 A. L. R. 554, and note at p. 572.

In the Restatement of the Law of Trusts, Sec. 243, subsec. d, the rule is thus succinctly stated:

> "If the trustee *repudiates* the trust or misappropriates the trust property or if he *intentionally* or negligently mismanages the whole trust, he will ordinarily be allowed no compensation." (Italics ours.)

The District Court found, and the Circuit Court of Appeals concurred therein:

> (1) The Kentucky group "attempted to appropriate all of the stock to themselves, without notice to the Tennessee Group. In numerous other ways they revealed a deliberate design to deprive their Tennessee associates of all beneficial interest in the corporations."
> Opinion 29 Fed. Supp. 664;
> Finding of facts (23) R. I, p. 391.

> (2) That they engaged in various specific instances of misconduct, and in "various other questionable transactions in connection with the business, all without the knowledge of or notice to the Tennessee Group".
> Finding of facts (21) R. I, pp. 390-391.

> (3) That their use of trust funds to promote their own interests, "was clearly wrong and indefensible".
> Finding (44) R. I, pp. 399-400.

> (4) That they were guilty of "fraudulent breach of trust".
> Conclusion (20) R. I, p. 416.

We cite some of the instances making up the "fraudulent breach of trust" found by the Courts below:

Reference has already been made to the deliberate attempt of the Kentucky group at the organization meetings to appropriate to themselves all of the stock of both corporations (R. VI, pp. 1812-18), and this at a time when Mr. Johnson concedes the Tennessee Group were entitled to equal ownership of the stock (R. III, p. 790, Qs. 620-21). In the face of this action, Mr. Johnson, Sr., wrote Messrs. Powell and McArthur, of the Tennessee Group, advising them that the organization meetings had been held and requesting that they put up their part of the agreed working capital (R. II, pp. 80-81). The Tennessee group were not advised of this action and did not know of it until near the close of the trial below, when Mr. Johnson produced some minutes which were written up after this suit started (R. VI, pp. 1820-24). Johnson, Sr., was asked why he did not invite Richardson and Garth to attend the organization meetings, the latter of whom was on the ground, to which he replied he thought the Tennessee group were to pay for their stock only if the first sale was confirmed on appeal. Thereupon the Court reminded him this action was taken before the reversal of the first sale (R. III, pp. 817-20). This excuse is clearly a specious one. If it were not intended that the Tennessee group should take and pay for one-half of the stock, why did the parties go to the trouble of having them subscribe for one-half?

The Kentucky group appropriated to themselves large salaries, the first year of the operation of the business, to-wit: the year 1930, aggregating the sum of $34,100.00 (Bl. Grass Min. Co. Aud. p. 35, and Pendleton Store Audit, p. 39).

The only statements ever rendered to the Tennessee group for January, February and March, 1930 (R. II, pp. 410-43 and R. III, 433-446), showed no salaries to proprietors or executives but Pendleton Store statements did show

a payment to J. E. Johnson, Jr., of $50.00 for legal services, and salary of Arch Pendleton of $150.00 (R. II, p. 425) and a payment to "Wm. Pendleton of $150.00 (salary for January, Feb. and March)", (See R. III, p. 434). These statements were false. The minutes of the meeting of January 15, 1930, showed the directors had fixed the salaries for Pendleton Store for Wm. Pendleton at $2,400.00 for 1930; for Arch Pendleton at $5,000.00, and for J. E. Johnson, Jr., at $2,400.00 "Said salary to be in lieu of all other fees" (R. VI, pp. 1819-20). As a matter of fact the minute entry was false, as well as the entry on the books of account at July 31, 1930, setting up salaries for the Kentucky group and charging them with stock subscriptions, because the witnesses testified no salaries were agreed upon or fixed until November or later in 1930 (R. III, pp. 661-2; 681-2; 810-12).

The day after Mr. Johnson had by false representations induced Richardson, Trustee to sign the alleged contract of February 18, 1931, putting as he evidently thought, the Tennessee group in the position of minority stockholders, he began having Blue Grass lend money to Black Gold Mining Company (they had already furnished labor and credit (R. IV, pp. 1414-15)), the first loan being February 19, 1931, and kept it up until the total loans and advancements aggregated $22,242.31. (Ex. X Lavinder.) Mr. Johnson very distinctly recalled no loans were made until after the alleged contract of February 18, 1931 (R. V, p. 1640). Less than three months before these loans started Mr. Johnson had written Mr. McArthur that the Blue Grass was having a hard time to get money to meet its pay roll (R. II, p. 355). In August, 1931, Johnson began lending the corporate funds to the aggregate of $4,302.15, to Chavies Coal Co. (Ex. X Lavinder), a Johnson company organized by him to take over one which he had operated to bankruptcy (R. V, pp. 1702-4). And in August, 1931, he caused Blue

Grass Mining Company to lend $1,000.00 to Johnson Supply Company and to buy its stock certificate book for $5.25 (Ex. X Lavinder). This was a Johnson Company (R. V, pp. 1700-01). In November, 1933, Johnson caused corporate funds to be loaned to Eagle Coal Company in the sum of $816.00 (Ex. X Lavinder) which was owned by Johnson, Pendleton and Davis (R. V, p. 1701). In 1934 he loaned corporate funds to Sun Fire Coal Company to the extent of $7,750.00 (R. IV, pp. 912-18), this latter company being owned by J. E. Johnson, Jr., Wm. Pendleton and Arch Pendleton (R. V, p. 1701). These loans were subsequently repaid. No interest was paid on any of these loans, except a small amount on a part of the Black Gold loan.

The ink was scarcely dry on the Sun Fire loan when Pendleton and Joe Johnson, Jr., in response to an urgent appeal from Mr. Powell who was sick and needed help, wrote Mr. Powell that Blue Grass Mining Company was hard up, could not keep enough money to run the business and had to borrow to meet expenses (R. IV, pp. 902-4).

Although it appears by pleadings sworn to by Mr. Johnson, and orders entered in suits involving the properties that the properties were bid in at the second sale by Johnson, Jr., for the use and benefit of Blue Grass Mining Company (R. V, pp. 1673-78; 1688-92; 1694-99) and admitted by Johnson, Sr., that it was bought at the second sale for Blue Grass Mining Company (R. III, p. 728; R. III, p. 791), Johnson, Jr., insisted he bought it for himself and father (R. IV, p. 959), and they set up royalties on books of the Blue Grass Mining Company of nearly Forty Thousand Dollars (R. V, p. 1534; R. III, pp. 699-703).

Johnson, Sr., used $9,020.00 of Blue Grass funds in 1935 to buy a tract of coal land needed by the Company, known as the Crawford tract. However, he took title in his own name, later borrowed money on a note to be paid out of royalties to repay the Mining Company, leased the land to

the Mining Company and at the time of this suit had drawn $12,245.00 in royalties (R. III, p. 610; R. V, p. 1416; R. III, pp. 851-56), (Decree Sec. VII, R. I, pp. 422-23). We particularly invite the Court to read Mr. Johnson's testimony regarding this transaction, under questioning by the District Judge beginning at Record III, p. 852, as illustrating his callousness toward his obligations as a trustee. He insisted upon holding this land until ordered in the case to convey it to the Mining Company.

The Baker tract was purchased by Wm. Pendleton for $600.00, leased by him to Blue Grass by whom it was needed, and from which the royalties drawn by Mr. Pendleton and the Johnsons amounted to over six thousand dollars (R. IV, pp. 928-35; R. V, pp. 1415-16; R. I, p. 395; R. III, p. 611; R. V, p. 1415; Decree Sec. VIII, R. I, pp. 424-5).

The Kentucky group organized a sales company with funds of Blue Grass Mining Company and claimed the stock in their own names and insisted upon such claim until the Court decreed ownership to Blue Grass Mining Company in this case (R. VI, pp. 1749-53; R. I, p. 425).

The Kentucky group employed numerous members of their families and not only paid them salaries but paid and set up large bonuses for them, which the Court was compelled to order paid back or cancelled (R. I, pp. 400-01; R. VI, pp. 2070-98; Decree XIV, R. I, p. 427).

The Kentucky group always led the Tennessee group to believe the companies were making no money and were hard up (R. II, pp. 206-7; 333; Ex. 11, R. II, p. 344; Ex. 17, R. II, pp. 355-56; p. 547; R. IV, pp. 901-5; R. IV, p. 912; R. IV, p. 917). Notwithstanding these representations they were lending Blue Grass money to themselves and their other corporations in sums aggregating in excess of $40,000.00, and drew out of the two corporations in cash, from 1930 until this suit was tried $166,655.07 in salaries (R. I, pp. 405-6; R. VI, pp. 1983-89), and from Black Gold, financed

largely or altogether by Blue Grass funds, over $50,000.00 (R. I, p. 407), and in 1936, while this suit was pending they declared to themselves a 100% dividend on all stock of Pendleton Store, Inc., and a 50% dividend on all the stock of Blue Grass Mining Company, to the exclusion of petitioners (R. I, p. 393). They made all sorts of false entries upon the books (R. IV, pp. 1156-58; 1163-68; 1173-74; 1189; 1193-94; 1211-12; 1262; R. V, pp. 1501-04; 1550-51; 1518-22; 1760, 1810).

They engaged in other questionable transactions too numerous and some too petty to annoy the Court with, such as payment of the license for a privately operated tavern; withdrawal of $5000.00 from the insurance or Workmen's Compensation fund. Finally, after having treated and dealt with complainants as co-stockholders and co-adventurers for about seven years, they come into Court and denounce their trust, deny complainants have any rights or interest, and assert that the $2500.00, one-half of agreed working capital called for by Mr. Johnson (Powell Ex. 2, R. II, pp. 80-81), and promptly put up by complainants (R. II, pp. 9; 45; 82-3), was not working capital at all but was advanced as a loan (Amended Ans. R. I, p. 213). Indeed their bookkeeper and witness Simpson, said it was a gift (R. V, p. 1535).

This claim was so utterly unfounded as to border upon the ridiculous and very properly received scant attention by the Trial Court (R. I, pp. 364, 366, 387). The Kentucky group never did put up their one-half the working capital, though Mr. Johnson did advance $1495.00 in opening the mine which he charged to expenses and got back in 1930 (R. VI, p. 2056), and this $2500.00 was all the actual invested capital ever put into the two companies. In the face of this fact, and of their own failure to put up their share of the capital, Johnson, Sr., swore in this case that $5000.00 capital was wholly inadequate (R. III, p. 649). But on cross-

examination he admitted that this $2500.00 was all the money put into the corporations and had resulted in earning about $80,000.00 (this was after the auditor threw back into earnings royalties set up), and had paid executive salaries in excess of $150,000.00 (R. III, pp. 713-32, Q. 389).

We thus find a wilful, premeditated fraud running through all of the dealings of these members of the Kentucky group with the corporations and with their co-stockholders, the members of the Tennessee group. We know of no case where trustees who have been guilty of such a consistent course of misconduct have been allowed compensation for their services. We respectfully submit the case of *Pierce* v. *Dahlgren*, 300 Fed. 268 (C. C. A. 6th) cited by the Honorable District Judge does not support his allowance of compensation. In that case, the Circuit Court of Appeals, Sixth Circuit, speaking through Judge Denison, before allowing the Trustee's salary, was at great pains to discover whether she was acting in good or bad faith in her dereliction of duty in making a loan to herself secured by a pledge of her interest in the estate. The care with which Judge Denison went into the question of good faith strongly indicates his decision would have been otherwise if the misconduct had been wilful and in bad faith. Judge Denison cited in support of the decision of the court in the Pierce case, the case of *Garesche* v. *Levering Co.*, 146 Mo. 436, 48 S. W. 653, 46 L. R. A. 232. An examination of this last case reveals that the good faith of the trustee was made the touchstone for the allowance of compensation. The same is true of *Paducah Land &c. Co.* v. *Hayes*, 15 Ky., L. R. 517, 24 S. W. 237, likewise cited by the learned District Judge in support of his opinion. In this latter case the Court held the trustee, President of the corporation, had accounted for all stock sold, and as to stock not sold, but held by him, he was liable for its value rather than for the price at which he might have sold it, "as his was not a wrongful conver-

sion". Thus he was acquitted of any fraud or intentional wrong, and nothing other than mistake of judgment stood in the way of allowance of compensation. Nor do we believe the other authorities cited, that is, 65 C. J., p. 929, Sec. 840 (R. I, p. 377), afford support for the opinion under the facts of the case at bar. In fact that section opens with a statement of the general rule that a trustee who neglects his duties, or is guilty of bad faith, or violates his obligations, "*or who repudiates the trust, claiming title as absolute owner,*" forfeits his compensation. (Italics ours.) The section then states the exceptions to the general rule, but we submit the case does not come within the exceptions. On the contrary in the case at bar the trustees violated their obligations, were guilty of bad faith, repudiated the trust, and claimed the title as absolute owners.

Flint River Pecan Co. v. *Fry, supra,* and *Backus* v. *Finklestein, supra,* in both of which compensation was denied, are nearly parallel in their facts to the case at bar.

The record in this cause will disclose that the respondents worked primarily at all times for their own benefit, and only incidentally for the benefit of the corporations of which they were officers and directors. Compensation should be the reward of faithful and honest service, and never of unfaithful self-service, especially where the trust estate and beneficiaries have been by the trustees put to an enormous expense as in this case, to establish the trust and bring the trustees to account.

V.

The opinion and decree of the courts below permitting the respondent trustees to hold the stock of Black Gold Mining Company are probably contrary to the decisions of this Court, the courts of other circuits including the Sixth Circuit, and to the weight of authority.

The facts with reference to the organization by members of the Kentucky group of Black Gold Mining Company, as

found by the Trial Court and concurred in by the Circuit Court of Appeals (Finding of Facts No. 44), will be found at pages 399-400, Volume I of the printed record. Stated in little more detail, they are as follows:

Black Gold Mining Company was organized by members of the Kentucky group with whom is also associated W. E. Davis, the Receiver in the State Court proceeding, from whom the Blue Grass properties had been purchased, and one H. K. English, a coal operator of repute in that section of Kentucky (R. III, p. 660). English put no money into the business and soon sold out what interest he may have had to Johnson, Sr., a member of the Kentucky group (R. III, p. 721). William Pendleton and J. E. Johnson, Jr., were or became interested (R. III, pp. 841 and 868). No stock was ever issued, but the stockholders at the time of the trial of this case were W. E. Davis, $1667.00; William Pendleton $1667.00; J. E. Johnson, Jr., $1666.00, and the stockholders of Jeda Coal Company, which is only a holding company, were J. E. Johnson, Sr., J. E. Johnson, Jr., Wm. Pendleton, all members of the Kentucky group, and E. J. Davis and W. E. Davis. The stock, according to the books was paid for by setting up salaries and charging those salaries with stock subscriptions (R. V, pp. 1654-55).

On December 12, 1930, Hazard Coal Corporation, which owned the property subsequently acquired by Jeda and Black Gold, entered into a contract with Johnson, Sr., and H. K. English agreeing to lease to Johnson, English and W. E. Davis, the properties known as the Ashless properties, and permitting them to transfer it to a corporation of $25,000.00 paid in capital, or to make the lease direct to the corporation and to lend to them $10,000.00 to be repaid in installments equal to 5¢ per ton on coal mined from the properties (R. VI, p. 1756). Davis did not sign the contract but agreed to be bound (R. VI, pp. 1756-57). The lease was subsequently executed by the Hazard Coal

Corporation direct to Jeda, which Company was to pay its lessor 10¢ per ton royalty on all coal mined and also a rental for the use of improvements and equipment on the property, equal to 7½¢ per ton on all coal mined, which royalty and rental payments were actually paid by Black Gold as sub-lessee direct to Hazard Coal Corporation (R. V, p. 1711; R. IV, p. 1195).

Jeda never had any books and kept no bank account after its organization, all of its accounts and books being handled through Black Gold (R. V, pp. 1711-12; R. IV, pp. 1194-99). In fact after Jeda leased the property to Black Gold there was no further necessity for its existence except to hold the lease from the Hazard Company. Black Gold began operating and shipping coal in January or February, 1931 (R. III, p. 660; R. V, p. 1653). In order to get Black Gold started, Wm. Pendleton and F. A. Garth, employees of Blue Grass, were loaned to Black Gold (R. V, p. 1711; R. III, p. 620; R. IV, pp. 1414-15). It drew upon Blue Grass Mining for cash, taxes, engineering expenses, labor, printing, tramroad and miscellaneous items, aggregating in 1931 $9,386.64; and borrowed from Blue Grass Mining Company on February 19, 1931, $1,500.00; February 28, 1931, $500.00; April 4, 1931, $300.00; May 9, 1931, $300.00; May 12, 1931, $3,000.00 and June 29, 1931, $200.00, the advancements and loans from Blue Grass Mining Company to Black Gold in that year of its organization $13,886.64. In 1932, the Kentucky group had Blue Grass Mining Company to lend Black Gold $2,405.00, and had it to advance it money to pay expenses, labor, engineering, etc., $3,379.17, and in 1933 had the Blue Grass to lend Black Gold $500.00 and to advance engineering costs of $601.80, the aggregate of the funds loaned and labor and money advanced by Blue Grass Mining Company to Black Gold in the years 1931 to 1933, inclusive, being $22,342.61 (Lav. Ex. X; R. I, p. 400).

The $10,000.00 borrowed from Hazard Coal Corporation by the organizers of Black Gold was not put into the business until 1931, (R. V, pp. 1708, 1715), after the Company had been started by the use of Blue Grass funds and was shipping coal, and this $10,000.00 was paid back from the sinking fund of 5¢ per ton on the coal mined.

It was not until April 17, 1931, when Black Gold was then a going concern as the result of the use of Blue Grass money, that the Kentucky group put any money into it whatsoever, at which time, although petitioners insisted below no money was put in by the Kentucky group, the Court found that J. E. Johnson, Sr., put $5,000.00 into the business. No other money was put in by the Kentucky group or anyone else, other than the $10,000.00 which was paid back from coal mined (R. I, p. 399).

Black Gold and Jeda Corporations were founded and financed to the operating stage wholly and exclusively by Blue Grass funds and the credit for its foundation enabled it to repay the $10,000.00 borrowed by its organizers from the sinking fund of 5¢ per ton on coal mined, and further enabled it to pay $50,000.00 in salaries to members of the Kentucky group and their associate, W. E. Davis. The Court found that Black Gold was not financed wholly by Blue Grass funds, and this may be technically correct in that some money was borrowed by its organizers, but this money was paid back out of coal mined and the mining operations were started and the Company launched upon a successful career wholly by the use of Blue Grass money. This money was subsequently paid back by Black Gold Mining Company to the Blue Grass Mining Company, but not until after the $10,000.00 which had been borrowed by its organizers and put into the business had been repaid, and then only with interest on a part of it. By reason of this repayment the trial Court held that the Blue Grass Mining

Company had not suffered a loss. However, the record shows that these funds which the Kentucky group loaned to themselves were at all times needed in the business of the Blue Grass Mining Company, and that it suffered by reason of not having this capital in its business in numerous ways, according to the evidence of most of the Kentucky group themselves. Whether it did or did not suffer a loss, however, we submit is not controlling, but the fact that the members of the Kentucky group loaned this money to themselves, from which they made large profits, entitles the Blue Grass Mining Company as a matter of law, to these profits. As said by this Court in *Barney* v. *Saunders:*

> "It is a well-settled principle of equity, that wherever a trustee, or one standing in a fiduciary character, deals with the trust estate for his own personal profit, he shall account to the cestui que trust for all the gain which he has made. If he uses the trust money in speculations, dangerous though profitable, the risk will be his own, but the profit will inure to the cestui que trust. Such a rule, though rigid, is necessary to prevent malversation."
>
> *Barney* v. *Saunders*, 16 Howard 542-3, 14 L. Ed. 1051.

The opinion and decree of the lower courts are probably in conflict with the decisions of this Court in *Barney* v. *Saunders, supra,* and the following:

Hollins v. *Brierfield Coal & I. Co.*, 150 U. S. 371, 14 Sup. Ct. Rep. 127, 37 L. Ed. 1113.

Twin-Lick Oil Co. v. *Marbury*, 91 U. S. 587, 23 L. Ed. 328.

Koehler v. *Black River Falls Iron Co.*, 2 Black 715, 17 L. Ed. 339.

Jackson v. *Ludeling*, 21 Wall. 616, 22 L. Ed. 492.

Wardell v. *Union P. R. Co.*, 103 U. S. 651, 26 L. Ed. 509.

Wright v. *Kentucky &c. G. E. R. Co.*, 117 U. S. 72, 6 Sup. Ct. Rep. 697, 29 L. Ed. 821.

Drury v. *Milwaukee &c. S. R. Co.*, 7 Wall. 299, 19 L. Ed. 40.

See also *Backus* v. *Finklestein, supra, Webster Loose Leaf Filing Co.*, 252 Fed. 959. In lending money of the Blue Grass Mining Company to Black Gold Mining Company, the Kentucky group were lending it to themselves. *Geddes* v. *Anaconda Copper Min. Co.*, 254 U. S. 590, 65 L. Ed. 425; *Highland Cotton Mills* v. *Rayon Knitting Mills*, 194 N. C. 88, 138 S. E. 431.

The matters involved in this petition, while upon their face appear to be a controversy between private citizens in which it may be argued the public has no interest, nevertheless we respectfully submit that they are charged with a public interest, since the very foundation of society rests upon the principles of common honesty and fair dealing in business matters, and it is a matter of public interest that those occupying a fiduciary relation should be held to the highest and strictest degree of good-faith and fair dealing. We apprehend this may be accomplished by an unbending application of the harsh rules to trustees found to be guilty of wilful misconduct or of fraud in fact. Any relaxation of the high standard set by the courts for the conduct of persons occupying a fiduciary relationship must have an effect reaching far beyond the circle of those immediately involved. It is not enough that unfaithful trustees should be required to restore a part or even all of their illegal gains from the use of the trust property, as this would be an encouragement of such trustees to gamble with trust funds in the belief that if they should be challenged they at least might reap some profit from or recover some compensation for handling the trust estate. Where wilful misconduct, bad-faith and fraudulent breach of trust are established, as

has been in this case, and as was found by the Courts below, the harsh rule should be applied, in our opinion, denying the unfaithful trustees any compensation and stripping them of all gains which they may have made by the use of the trust estate.

We respectfully submit that the language used by the late Mr. Justice Cardozo, then Chief Justice of the New York Court of Appeals, in *Meinhard* v. *Salmon,* 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1, is apropos:

> "Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

No. [redacted] 110

W. E. RICHARDSON, in His Own Right and as Trustee, and Others,

Petitioners,

vs.

BLUE GRASS MINING CO., and Others,

Respondents.

BRIEF FOR RESPONDENTS

In Opposition to the Petition for Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

No. 1274.

W. E. RICHARDSON, in His Own Right and as Trustee, and Others,

Petitioners,

vs.

BLUE GRASS MINING CO., and Others,

Respondents.

BRIEF FOR RESPONDENTS

In Opposition to the Petition for Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The respondents, Blue Grass Mining Company and others, in opposition to the petition herein for a writ of certiorari to the Circuit Court of Appeals for the Sixth Circuit, respectfully represent:

I.

The opening statements of the petition herein do not correctly describe the nature, purport or purpose of the action. Its character is to be determined from the bill of complaint (Record, Vol. 1, pp. 1-53). It sets up the written contract of December 7, 1929, the various articles of incorporation of the five companies, and the written contract of February 18, 1931. It did not allege any breach of either contract, or that any subscription for the stock of the corporations had been paid for by plaintiffs.

It assumed that the mere signing by dummies of the articles of incorporation of Blue Grass Mining Co. and Pendleton Stores, Inc., constituted the complainants stockholders and expressly sought (1) a reformation of the contract of February 18, 1931, so as to give them a 50 per cent interest instead of a 30 per cent interest provided by the contract, and (2) an accounting by the officers of the corporations for salaries and expenses paid to them from year to year from 1930 to 1936, and for certain other items.

The bill of complaint was amended eight times:

1. First amended bill, Vol. 1, p. 137.
2. Amended and supplemental bill, Vol. 1, p. 144.
3. Further and better statement, Vol. 1, p. 152.
4. Amendment to conform to proof, Vol. 1, p. 182.
5. Further amendment and supplemental bill, Vol. 1, p. 255.
6. Bill of particulars, Vol. 1, p. 282.
7. Amended and supplemental bill, Vol. 1, p. 326.
8. Second amendment to bill of particulars, Vol. 1, p. 332.

The essential character of the action was never changed except the reformation of the contract of February 18, 1931, sought in the original bill, was changed on August 2, 1937 (more than five years after the contract was made),

to a prayer for a rescission of that contract (Record, Vol. 1, p. 182).

At no time nor by any pleading did the complainants seek to establish the quantum of interest in the contracts other than the claim in the bill that they "were entitled to one-half of the stock in the two corporations" (Record, Vol. 1, p. 3). They did not allege that they ever paid any money on the subscriptions and, in truth, never did so. A full and complete statement of the facts is necessary in view of the distorted, inexact and inaccurate "Statement of the Case" by petitioners.

II.

STATEMENT OF THE CASE.

J. E. Johnson, Sr., was the owner of a bid for certain coal properties at Hazard, Kentucky, sold at a receiver's sale under a decree of the Perry Circuit Court. He had paid $2,800.00 of the purchase price, and had executed sale bonds for the balance of $11,200.00. In addition, he had expended about $8,000.00, and had arranged to pay certain lien claims on a royalty basis of 10 cents per ton of coal mined from the No. 7 seam. Mr. Johnson had matured plans for operation of the property under the bid, and for the formation of two or three corporations to operate the mines, to conduct the commissary, and to hold the title of the real estate. William Pendleton had been started to work, and was engaged in preparation. In this situation, M. T. MrArthur and Ferdinand Powell of Johnson City, Tennessee, began negotiations for the purchase of an interest in the bid which Mr. Johnson held. The negotiation resulted in a written contract dated December 7, 1929, which was the origin and the measure of the rights acquired and the obligations assumed. The subject matter of the contract was the bid. The contract is Exhibit A with the bill of complaint (Record, Vol. 1, pp. 53-55).

It will be observed that the contract protected the plaintiffs against any liability whatever except in so far as they expressly consented. It was signed by M. T. McArthur, trustee, who represented, as later appeared, himself, Mrs. Ferdinand Powell, W. E. Richardson and R. W. Lawson.

The contract gave McArthur, trustee,

> (1) A one-half interest in the bid and the property acquired or to be acquired thereunder. But until title to such property was vested in the parties in equal moieties no obligation was imposed; and
>
> (2) One-half of the stock in the one, two or three corporations that might be organized to own and operate the mines, or to do either. These rights were dependent and conditional on the confirmation of the sale to Mr. Johnson, it being known that an appeal to the Court of Appeals was then contemplated (Record, Vol. 2, pp. 329-335).

The contract obligated M. T. McArthur, trustee, as follows:

> (1) To pay $1,400 in cash, which was to be returned to McArthur by the Receiver in the event the sale was not confirmed by the Court of Appeals.
>
> (2) To pay Mr. Johnson $4,000 when and after the sale was confirmed, and "title vested in the parties to the contract, or their assignees, in equal moieties";
>
> (3) To bear one-half of the costs incurred thereafter, but only by agreement as to such expense; and any compromise or settlements were to be made by both parties agreeing thereto and each paying one-half thereof;
>
> (4) To accept the royalty agreement theretofore made as a means of paying labor and compensation claims from coal mined from No. 7 seam, which arrangement was ratified and adopted;
>
> (5) To pay one-half of the sale bonds of $11,200 on which Johnson was obligated. Each party was to pay

$5,600 thereof, if it became payable as a result of confirmation of the sale by the court of last resort;

(6) To take one-half of the stock in one, two or three corporations to be organized, to own and operate the mines and store, but only "in the event the sale was confirmed."

Pursuant to this contract, two corporations were organized. One was The Blue Grass Mining Company, with an authorized capital stock of $10,000, to operate the mines, and the other was the Pendleton Stores, Inc., with an authorized capital stock of $5,000, to conduct the commissary. The title to the bid was held by F. J. Eversole, but was controlled by the parties to the contract, and the organization of a corporation for that purpose was deferred until the title was confirmed. The articles of incorporation of both companies were signed by selected persons representing the contracting parties. Neither J. E. Johnson, Sr., nor M. T. McArthur, trustee, signed the articles of incorporation of either company, but this was not material, as the corporations were organized pursuant to the contract and subject to the control of Johnson and McArthur. The corporations were mere instrumentalities under the contract. No stock was issued or paid for until after the first contract was ended by the Court of Appeals when it reversed the judgment of confirmation. Mr. Johnson and his associates then paid up the stock in both companies. The reversal of the judgment destroyed the subject matter of the contract, which was the bid. McArthur and associates put up $2,500 in the form of check signed by Mrs. Ferdinand Powell. This was entered on the books as a debt due Mrs. Powell from the corporation, and was so carried throughout the period of this litigation, with certain credits thereon by reason of payments made back to the Powells. In fact, more than half of the amount was returned to them. Johnson put up $1,500, which was en-

tered on the books in the favor of J. E. Johnson, Jr., who had actually expended the money for the company (Record, Vol. 4, p. 953), and the bookkeeper entered it to his credit (Record, Vol. 3, p. 664). It was the money of J. E. Johnson, Sr., and was later changed on the books to his credit (Record, Vol. 2, p. 305). In addition, Johnson had spent $8,000, as shown by both contracts and as alleged in the bill itself (Vol. 1, p. 6). The parties began at once to put the coal mines in shape, and actually shipped coal on January 1, 1930 (Record, Powell Exhibit No. 4, Vol. 2, p. 83). Arrangements were made with the Midland Coal Sales Company to advance money on coal shipped, and in that way the operations were carried on until May 30, 1930, on which dates the Court of Appeals reversed the judgment of the Perry Circuit Court and set aside the sale (Wakenva Coal Co. v. Johnson, 234 Ky. 558, 28 S. W. [2d] 737).

The effect of this judgment was to extinguish the bid which was the subject matter of the first contract. In legal effect it terminated the contractual relations existing between the parties, and relieved M. T. McArthur, trustee, of all obligations under the contract, and of all obligations incidental thereto. Any earnings or assets of the corporations acquired during the period of operation would have to be accounted for to the true owners of the property, and hence there was no occasion or motive for McArthur, trustee, to remain in the matter, unless a new contract for the purchase of the land could be negotiated.

The Blue Grass Mining Company negotiated a contract with the Receiver to operate the mines pending a resale of the property. When the Court ordered a resale of the property it was ordered in two parts. The first portion was sold on October 27, 1930, and was purchased by J. E. Johnson, Jr., who gave the bond required by law. On December 22, 1930, the remainder of the property was

sold and bid in by S. P. Camack, whose bid was duly assigned to J. E. Johnson, Jr. Immediately thereafter, on December 27, 1930, Ferdinand Powell opened negotiations for an interest in the new purchase (Record, Powell Exhibit No. 20, Vol. 2, page 130). Negotiations continued, but no contract resulted. On February 7, 1931 (Record, Powell Exhibit No. 81, Vol. 2, page 264), Powell expressed a willingness to accept a new contract on the basis of 35 per cent to McArthur and his associates, 35 per cent to Johnson and his associates, and for Johnson to place "30 per cent as he saw fit," with a further agreement for reimbursement to both parties of amounts theretofore paid, and for the Tennessee group to be relieved of paying the $4,000 referred to in the contract of December 7, 1927. He also desired an option at $5,000.00 on 5 per cent of the stock in the new company to be organized. Powell stated in that letter that so far no headway had been made towards a new contract, and he hoped that they would be able to reach an agreement so that, in case of failure to do so, each party might know where he stood. The letter resulted in a meeting on February 18, 1931, when a new contract was completed after long discussion, and after the rejection of a proposed contract written by Powell. This contract is Exhibit F with the bill of complaint (Record, Vol. 1, pages 69-71). This contract defined the rights of the parties in all respects, superseding all prior negotiations, rights or understandings, express or implied. It differed in some material respects from the previous contract of December 7, 1929, and did not provide for the bids or any interest therein to be assigned or transferred to Mr. Richardson, trustee, who signed the agreement, but expressly provided for both bids to be assigned, transferred and vested by J. E. Johnson, Jr., in a new corporation to be organized by the parties in which the stock was to be held on the basis of 30 per cent to Richardson and associates and 70 per cent to Johnson and

associates. This was the form or plan stipulated by the parties, and after it was executed it was necessary for all parties to follow it in order to obtain the rights it gave. It constituted a settlement of any dispute or claim, and a compromise of any controversy growing out of prior transactions, duties or obligations.

The contract was complete and comprehensive. It provided that Richardson, trustee, should have the rights specified, to wit:

(1) 30 per cent of the stock of a corporation to be organized by the parties;

(2) 30 per cent of the stock of Blue Grass Mining Company;

(3) 30 per cent of the stock of Pendleton Store, Inc.;

(4) Relief from payment of $4,000.00 required by the contract of December 7, 1929 (in fact, the reversal of the judgment by the Court of Appeals had already extinguished that obligation);

(5) Payment by the corporation to be created of $3,900.00 to Richardson;

(6) 30 per cent of a one-third stock interest in Jeda Coal Co.;

(7) 30 per cent of a third stock interest in Black Gold Mining Co. (but the one-third interests in Jeda Coal and Black Gold were to become assets of the corporation to be created);

(8) If a sales company should be formed, Richardson, trustee, could subscribe for and take 50 per cent of the capital stock of such sales company.

Johnson and his associates were to have 70 per cent of everything in which Richardson, trustee, was to have 30 per cent, and 50 per cent of the sales company stock, if one were organized. Johnson was to be paid $7,500.00 by the corporation to be organized by the parties.

Thus, the corporation to be organized was to take over the properties bid in and held by J. E. Johnson, Jr., and was to pay the purchase price. It was to take 30 per cent of one-third of the stock in both Jeda and Black Gold, and pay for it. It was to pay Johnson $7,500.00, and Richardson, trustee, $3,900.00.

A policy of life insurance in the amount of $25,000.00 on the life of J. E. Johnson, Sr., was to go to the proposed new company, and, necessarily, it would have to pay the cost of carrying the insurance from the beginning. The obligations thus to be assumed by the corporation to be formed by the parties appeared to be as follows:

(a) To pay the purchase price.....	$52,600.00
(b) To pay W. E. Richardson, trustee.....	3,900.00
(c) To pay J. E. Johnson, Sr.	7,500.00
(d) To pay Jeda Coal Co. (⅓ of $25,000)...	8,333.50
(e) To pay Black Gold (⅓ of $5,000).....	1,667.67
	$74,000.00

The cost of carrying the insurance would add at least $5,000.00. The contemplated corporation must have had at least $80,000.00 to discharge the obligations contemplated by the contract. Some operating capital would be required and the estimate of $100,000.00 mentioned from time to time was about the minimum requirement of the plan. Powell's letter of February 7, 1931 (Record, Exhibit No. 81, Vol. 2, p. 264), requested an option on 5 per cent of the stock at $5,000.00, which corroborates and confirms the estimate that an authorized capital of $100,000.00 was contemplated.

On May 25, 1931, the trustee, W. E. Richardson, filed a written declaration of trust (Record Vol. 2, pp. 38 and 39). It recited the holding of a 30 per cent interest under the contract of February 18, 1931, and declared that it was held for Miss T. R. Porter, one-half; Miss Margaret H.

Powell, three-tenths of the 40 per cent, and to W. E. Richardson and R. W. Lawson, one-fifth of the 30 per cent. It further declared that as soon as stock is issued in the companies now organized, or to be organized in pursuance to the contract, it would be turned over to the parties as set out.

This declaration defined the subject matter of the trust assumed by Richardson. He was trustee of nothing except the rights conferred by the contract of February 18, 1931. Operations continued under the contract of February 18, 1931, without question by anybody until February 8, 1936. There was a long delay caused by litigation in various forms, and other circumstances beyond the control of the parties. An appeal had been taken to the Court of Appeals from the orders confirming the second sales of the properties. By mutual assent nothing was done towards carrying out the contract until disposition of all controversies respecting the title of the property (Record Vol. 3, p. 484). In fact, it was impossible to go forward with the steps outlined by the contract until the title to the property was established. The contract was predicated on that proposition, and Mr. McArthur testified rather boastfully that he had protected his associates against any contribution to the enterprise until the title was assured (Record Vol. 2, p. 318; Vol. 4, pp. 1118-1119). Contrary to the present claim of petitioners, no request or demand was ever made by Richardson, trustee, for the issuance of stock. None was due to be issued until it was fully paid for in money (Ky. Cons. § 193, Ky. Stats. § 568). The second appeal to the Court of Appeals was settled on May 14, 1934 (Record Vol. 2, p. 399), but the other litigation could not be settled and had to be fought out in court. The attorneys for the creditors were claiming a large sum of money from Blue Grass Mining Company for operations on the property prior to the time the legal title was

acquired. The Blue Grass Mining Company was claiming an offset allowance for permanent improvements made during the time of operations. This litigation was not finally settled until after the present litigation was in progress, but in January, 1936, Mr. Johnson believed that the end of the controversy was in sight so that they could go forward under the contract of February 18, 1931. He called a meeting at Lexington to be held on February 8, 1936, and provided expense money for the plaintiffs to make the trip. They did not hold the meeting. Richardson and his associates had already employed and conferred with counsel and had determined to bring suit. The bill of complaint was at least partly prepared. Mr. Powell had prepared a written statement to read to the meeting, and unless the demand of the plaintiffs was accepted no meeting would be held. The gist of the demand was that the contract of February 18, 1931, be changed so as to give plaintiffs a 50 per cent interest instead of 30 per cent, as specified in the contract. No other part of the contract was questioned. All parties agree that up to this time no objections had been made as to the contract of February 18, 1931, or as to the rights or relations of the parties. The plaintiffs had never intimated that the contract of February 18, 1931, was not satisfactory, or that they would ask for anything else. Operations had been carried on under the contract for fully five years. Johnson and his associates had always recognized the contract of February 18, 1931, as defining the respective rights, liabilities and duties of the parties, and had operated on that basis. The refusal of the plaintiffs to go into the meeting on the existing contract, and the demand that it be radically reformed at that late day, constituted a repudiation and renunciation of the contract, and deprived the plaintiffs of all rights under it. It was a deliberate breach of the contract by the plaintiffs themselves.

Immediately thereafter, on February 17, 1936, this suit was filed in pursuance of the plan of action therefore formulated. This action was obviously taken on the advice of counsel. The bill of complaint (Record Vol. 1, pp. 1-53) did not assert any right of action under the contract of February 18, 1931, but sought to reform it so as to provide for 50 per cent to Richardson, trustee, instead of 30 per cent interest, in the two corporations which had been organized under and pursuant to the first contract. It did not allege any breach of the contract, or any performance of it on their part, or either ability, willingness or readiness to perform it. It sought only to reform the written contract so as to make the plaintiff's interest 50 per cent in the said corporations instead of 30 per cent, as the contract and declaration of trust provided. The pleadings were amended from time to time, and finally an amended petition was filed asking for a rescission of the contract on the ground of misrepresentation respecting the association of Mr. English in the enterprise (Record Vol. 1, pp. 144-151). This was more than five years after the contract was made and was too late.

Under well-settled principles of Kentucky law, an action for relief from fraud must be brought within five years from the time the cause of action accrued. Ky. Stats., § 2519. A petition that does not allege that the fraud was not discovered within the period of five years, and could not have been discovered within that time, is not good.

> Wood v. James, 87 Ky. 511;
> Brown v. Brown, 91 Ky. 639;
> Cox v. Simmerman, 243 Ky. 474, 48 S. W. (2d) 1078.

In this case there was no fraud in fact, but the circumstances respecting English upon which plaintiff relied and upon which the Court set aside the contract of February 18, 1931, were known by plaintiffs at all times.

Moreover, the petitioners had elected to abide by the contract and had raised no question about it for more than five years. It is well settled by the decisions of this Court, and of the Court of Appeals of Kentucky, that "when fraud in the making of a contract is discovered, the party defrauded has an election to rescind the contract or to stand upon it and sue for damages caused by the deceit. He must, in order to rescind, promptly so elect and notify the opposite party and adhere to the position taken." The election is irrevocable.

Grymes v. Sanders, 93 U. S. 55, 23 L. Ed. 798;
McLean v. Clapp, 141 U. S. 429, 35 L. Ed. 804;
Hoyt v. Latham, 143 U. S. 553, 35 L. Ed. 259;
Shappiro v. Goldberg, 192 U. S. 553, 48 L. Ed. 419;
Farmers Trust Co. v. Threlkeld's Admr., 257 Ky. 211, 77 S. W. (2d) 616;
Dolle v. Melrose Properties, 252 Ky. 482, 67 S. W. (2d) 706;
MacKenzie v. Eschmann's Exrs., 174 Ky. 450, 192 S. W. 521.

Moreover, the contract of February 18, 1931, was the only contract the complainants had. The first contract was upon a different subject matter—the bid at the first sale—and was ended by its own terms by the reversal of the judgment.

After the contract of February 18, 1931, was set aside they had no contract at all. Yet the Court gave them one-half of the stock in the Blue Grass Mining Company and one-half of the stock in the Pendleton Store, Inc., without requiring it to be paid for by complainants. The Court then proceeded to place in the Blue Grass Mining Company title to all the property that had been acquired and the entire capital stock of the Blue Grass Coal Co. (Sales Co.). This was in utter disregard of the plan of the parties from the beginning to keep the real estate and other property separate from the operating company.

The claim to the stock in Black Gold Mining Company and Jeda Coal Company was baseless. Those companies were organized on December 13, 1930, by W. E. Davis, E. J. Davis, H. K. English and J. E. Johnson (Record Vol. 5, pp. 1639-1640; Vol. 6, pp. 1755-1757). The claim that the Blue Grass Mining Company financed the companies is absolutely without a semblance of support. The owners of the stock in those corporations (except Mr. Johnson) are not parties to the appeal to the Circuit Court of Appeals or here.

After the contract of February 18, 1931, was made, and beginning on February 19, 1931, there were mutual accounts between the companies (Record Vol. 4, p. 1275). There never was any payment to Jeda Coal Co. It held title to the property acquired from Mr. Hull and leased to the Black Gold, which was an operating company.

The Black Gold and Blue Grass rendered mutual assistance in matters of marketing and in operating details. Sometimes the balance was in favor of Black Gold (Vol. 4, p. 1275). The contract of February 18, 1930, provided for a small stock interest in Black Gold and Jeda to be held by the corporation to be organized under the contract. When the balance was in favor of Blue Grass, interest was paid to it (Vol. 4, p. 1275).

The complainants were granted a great deal more than was fair or just or due them. The salaries and expenses were paid or credited each year and no complaint was made. Complainants were fully advised and had an agent on the ground at all times (Record, Vol. 2, pages 319-320). The properties and interests in property acquired from time to time were held according to the contract to be placed in the title-holding corporation when it should be organized, as expressly provided in the contract of February 18, 1931. The District Court revised the record of seven years and required respondents to pay back to the

corporation, Blue Grass Mining Co., large sums of money (Record, Vol. 1, p. 430). The District Judge said (Vol. 1, p. 377):

> "During a period when many other enterprises of the same character sustained heavy losses, or failed completely, the corporations here involved appear to have grown and prospered to an extent which seems really phenomenal. Obviously, this extraordinary development was due, in a large measure, to the experience, diligence and prudent supervision of J. E. Johnson, Sr. Efficient services rendered by the other members of the Kentucky group materially contributed to the successful achievement. The services so rendered extended far beyond those of a routine or perfunctory nature ordinarily expected of officers serving without pay. The Tennessee group acquiesced in the rendering of these services and as stockholders share in the benefits derived from them. These facts are amply sufficient to repel any presumption that they were to be rendered gratuitously. Fitzgerald Construction Co. v. Fitzgerald, 137 U. S. 98; Vaught v. Charleston National Bank, 62 F. (2d) 817; Paine v. Kentucky Refining Company, 159 Ky. 270, 167 S. W. 375."

Hence the Court allowed the respondents what he regarded as reasonable salaries for the years prior to March 1, 1937, but denied all compensation for 1937, 1938, 1939 and 1940, and required repayment of all in excess of what he allowed.

Without a dollar of investment, and in direct opposition to the written contract, the Court gave complainants a one-half interest in the two corporations, caused to be conveyed to the corporations all of the properties acquired and compelled Johnson and Pendleton to pay back to the corporation many thousands of dollars which they had earned and collected over the operating years with the assent and acquiescence of the complainants, and much of which had been paid to third parties for services to the

corporation. Instead of being aggrieved by the decree, the complainants have been unjustly enriched by it.

The men whose enterprise and ability originated and created the values have been penalized to enrich the complainants, who never had a dollar invested. The only money they ever put up was to be returned to them in full, under the contract of February 18, 1931, and in fact most of it had been returned to them before the suit was filed.

Instead of inadequate relief, the complainants have been given, contrary to their contract, a great and valuable interest and now seek in this Court to obtain still more of the earnings and savings of the respondents.

It is unfortunate that this Court cannot reverse the decree against the respondents and restore to them their rights and properties; but when the petition herein was filed it was too late for respondents to take a cross appeal.

The assumption that respondents were wrongdoers and had not kept their contract is absolutely unsupported by the record.

III.

RESPONSE TO BRIEF IN SUPPORT OF PETITION.

The brief for petitioners argues at great length that a trustee who had been guilty of a willful and fraudulent breach of trust, and tried to appropriate the trust estate, should be denied all compensation.

The answer to the abstract principle thus advanced is that no such case was presented by the record. There was no trustee, no breach of duty, and no attempt to take the estate.

The relationship here was purely contractual from the beginning to the end. The first contract of December 7, 1929, was the first step. The subject matter of that contract was the "bid" which Mr. Johnson controlled.

A "bid" is a property right and a proper subject matter for a contract.

Hughes v. Swope, 88 Ky. 254, 1 S. W. 394;
Johnson v. Baker, 246 Ky. 603, 55 S. W. (2d) 404.

That contract was conditioned on affirmance of the bid by the Court of Appeals. The reversal by the higher court extinguished the bid, destroyed the subject matter of the contract and ended the contractual relation.

13 C. J., Section 718, p. 643;
Juett v. C. N. O. & T. P. Ry. Co., 245 Ky. 379, 53 S. W. (2d) 551;
Aronson v. Gibbs Inman Co., 283 Ky. 107, 140 S. W. (2d) 806;
Texas Co. v. Hogarth Shipping Co., 256 U. S. 619, 65 L. Ed. 1123.

The parties recognized this and, when Mr. Johnson again bid in the property at later sales, they made the new contract of February 18, 1931. This contract then constituted the sole source of the rights of the parties to the contract.

The Eliza Lines, 199 U. S. 119, 59 L. Ed. 115.

This contract of February 18, 1931, was the only contract among the parties from that date forward. The corporations had been created under the first contract and no change was made in the organization of them and none was requested. Mr. Johnson and Mr. Pendleton operated them successfully. The petitioners had an agent on the ground at all times and assented to the management and to all the acts done, including the annual payment of salaries. The long delay was caused by litigation and circumstances beyond the control of either party. Until they could get a clear title to the property, the petitioners did not want to invest any mony or be responsible in any way.

They deliberately kept quiet and awaited the outcome of Johnson's efforts (Rec. Vol. 2, p. 362; Vol. 3, p. 484).

Such election is final and irrevocable and precludes petitioners from attacking the contract of February 18, 1931.

MacKenzie v. Eschmann's Exrs., 174 Ky. 450, 192 S. W. 521;
Farmers Trust Co. v. Threlkeld's Admr., 257 Ky. 211, 77 S. W. (2d) 616;
Grymes v. Sanders, 93 U. S. 55, 23 L. Ed. 798;
McLean v. Clapp, 141 U. S. 429, 35 L. Ed. 804;
Hoyt v. Latham, 143 U. S. 553, 35 L. Ed. 259;
Shappiro v. Goldberg, 192 U. S. 553, 48 L. Ed. 419.

The bill itself was fatally defective in failing to allege that the alleged fraud occurred within five years, or that it was not discovered within that period, and could not have been discovered by ordinary diligence.

Ky. Stats. 2515;
Wood v. James, 87 Ky. 511;
Brown v. Brown, 91 Ky. 639;
Cox v. Simmerman, 243 Ky. 474, 48 S. W. (2d) 1078.

These principles were ignored by the District Court and not even mentioned in the opinion filed.

With the contract of February 18, 1931, in force, the petitioners had no cause of action. They did not allege any breach of it by respondents, or any readiness or ability or willingness on their part to abide by it. That contract by its recitals and mutual covenants superseded all prior agreements, arrangements and negotiations and became the supreme source of the rights of the parties.

"There are two sorts of what has been termed estoppel by contract, viz., (1) estoppel to deny the truth of facts agreed upon and settled by force of entering into the con-

tract, and (2) estoppel arising from acts done under or in performance of the contract."

George v. Ford, 183 Ky. 813, 211 S. W. 438;
21 C. J., Sections 110-115, pp. 1110, 1113.

Moreover, when that contract was set aside, the petitioners had no contract at all with reference to the existing subject matter.

The prior contract relating to a previous bid could not be revived or applied to another and later bid on different terms.

A meeting was called for February 8, 1936, to be held at Lexington for the purpose of completing arrangements under the existing contract of February 18, 1931. The petitioners then for the first time questioned the contract, and made only the one question that they should have a half interest instead of the 30 per cent interest specified in the contract. This was not conceded and they refused to go into the meeting or to recognize the contract. This was a renunciation and breach of the contract and ended their rights under it.

Louisville Packing Co. v. Crain, 141 Ky. 379, 132 S. W. 575;
Roehm v. Horst, 178 U. S. 1, 44 L. Ed. 953;
Roller v. Leonard Co., 229 Fed. 615;
Fidelity & Deposit Co. v. Brown, 230 Ky. 534, 20 S. W. (2d) 284.

After this act by the petitioners they were not entitled to relief in any form or to any extent.

The District Judge said they were justified in the repudiation of the contract because (a) the Kentucky group had paid up and taken all the stock in the corporations; (b) had depleted the coal properties by five years operation; (c) and had made false representations respecting

English (Opinion, Record, Vol. 1, p. 365). The act in regard to the stock occurred in 1930, and prior to the making of the contract of February 18, 1931. It was assented to by petitioners, and by the terms of the last contract they were to purchase 30 per cent of the identical stock. The depletion of the mining property had nothing to do with the contractual relations of the parties. Not a word on that subject appears in pleading or proof, and it was not the reason given by complainants for repudiating the contract. It was a purely gratuitous assumption without any basis in fact or reason. It was never thought of by complainants. The final ground that misrepresentations were made respecting English was contrary to the previous ruling of the trial judge himself (Vol. 2, pp. 362-367).

It disregarded the rule that rescission cannot be made where the status quo cannot be restored.

> Pratt v. Carroll, 8 Cranch 471, 3 L. Ed. 627;
> Kauffman v. Raeder, 108 Fed. 171, 54 L. R. A. 247;
> Morris v. McDonald, 196 Ky. 716, 245 S. W. 903.

It disregarded the rule that action must be taken promptly upon discovery of the alleged fraud, and that an election to hold to the contract is irrevocable.

> Andrus v. St. Louis Smelting Co., 130 U. S. 649, 32 L. Ed. 1054;
> Head v. Oglesby, 175 Ky. 613, 194 S. W. 793.

After setting aside the contract of February 18, 1931, the complainants had no contract at all. But the Court gave them half of the stock in the Blue Grass Mining Company and Pendleton Store. This was in direct violation of the Constitution of Kentucky, Section 193, which reads:

> "No corporation shall issue stocks or bonds except for an equivalent in money paid or labor done, or property actually received and applied to the purposes for which such corporation was created, and neither

labor nor property shall be received in payment of stocks or bonds at a greater value than the market price at the time such labor was done or property delivered and all fictitious increase of stock or indebtedness shall be void."

The statute, section 568, is in the same language. The District Court used the dividends declared as late as December, 1936, and the $3,900.00 mentioned in the contract, which had been largely returned (Record, Vol. 1, p. 412). This was contrary to law, and very unjust to respondent, who had paid for all the stock in 1930, and had held it intact and obligated themselves to sell it to complainants in accordance with the terms of the contract of February 18, 1931.

Altenberg v. Grant, 85 Fed. 345;
Taylor v. Citizens Oil Co., 182 Ky. 350, 206 S. W. 644.

It is a fundamental law of contracts, applicable to contracts respecting stock in a corporation, that the contract of the parties will be enforced as made, provided it offends no rule of law, and a subscriber to stock is not bound to take stock except upon the terms and conditions of his subscription.

14 C. J., Sec. 832, page 536;
Putnam v. New Albany & S. C. J. R. Co., 16 Wall. 390, 21 L. Ed. 361.

It was not alleged nor proven that the plaintiffs ever paid or ever offered to pay for any stock in either of said corporations. The allegations that plaintiffs were entitled to certain stock is a legal conclusion, which is not only ineffective for any purpose, but is contradicted by the other facts alleged.

The corporation or its creditors might have enforced a subscription which had not been paid, but the parties to

the contract of December 7, 1929, could not do so except in accordance with the conditions of the agreement.

In 11 Encyclopedia of U. S. S. Court Reports, p. 205, the Supreme Court is quoted as follows:

> "Without express regulation to the contrary, a person becomes a stockholder (a) by subscribing for stock, (b) paying the amount of the subscription to the company or its proper officer, and (c) being entered on the books as a stockholder."
>
> Pacific Nat. Bank v. Eaton, 141 U. S. 227, 35 L. Ed. 702;
> Howley v. Upton, 102 U. S. 314, 26 L. Ed. 179;
> Potts v. Wallace, 146 U. S. 689, 36 L. Ed. 1135;
> Upton v. Tribilcock, 91 U. S. 45, 23 L. Ed. 203.

A contract fixing terms upon which stock may be obtained by performance of such terms does not constitute the contracting party a stockholder. The contract of February 18, 1931, foreclosed all that had gone before, and governed all that came after it. When complainants renounced and repudiated that contract, they cut off all right they had under it. Without performance of the conditions, a contract or option or right to purchase or to acquire stock in a corporation confers no beneficial interest in, lien upon, or title to, the stock.

Richardson v. Hardwick, 106 U. S. 255, 27 L. Ed. 145;
Life Preserver Suit Co. v. National L. P. Co., 252 Fed. 139;
Boyd County Fair Ass'n v. Eastham, 208 Ky. 368, 270 S. W. 12;
Bourne v. Miller, 4 Fed. (2d) 1007;
Greene v. Signa Iron Co., 88 Fed. 203;
Matheson v. Hicks, 10 Fed. (2d) 883;
French v. Hay, 89 U. S. 238, 22 L. Ed. 799.

The charge that Mr. Johnson and Mr. Pendleton sought to obtain personal profits at the expense of the corporation is repeated over and over in the argument, but it is without any basis in truth. The properties acquired and held in their names were for the benefit of the corporation to be organized, and it was never the plan or intention to put titles in the operating company. All these transactions were entered on the books and records, and it was expected that the contract of February 18, 1931, would be carried out and all assets would be vested in the new corporation as expressly agreed. Complainants assented to it at the time, and understood how and why it was done that way. Until the time for transfer arrived, the properties had to be held in some convenient form. The salaries set up or paid from year to year were based on the results of operations each year. It was proven without contradiction that they were reasonable and within the average of similar expenditures in the area involved (W. S. Denham, Vol. 6, p. 1771; R. H. Kelly, Vol. 5, pp. 1600-1622; W. W. Miller, Vol. 6, pp. 1623-1633; Turner Howard, Vol. 6, pp. 1843-1851; E. C. Perkins, Vol. 6, pp. 1827-1840.

Moreover, the assent and acquiescence of the complainants over the period including 1930, 1931, 1932, 1933, 1934, 1935 and 1936, in the amount of salaries allowed, was a complete bar to any later complaint by them.

IV.

JURISDICTION OF DISTRICT COURT.

The jurisdiction of the United States District Court is limited to controversies wholly between citizens of different states, when the cause of action does not arise under the Constitution or laws of the United States. The formal position of the parties is not decisive. The parties, to determine jurisdiction of the court, will be aligned accord-

ing to interest. The real, rather than the formal, party is regarded.

Stewart v. B. & O. Ry. Co., 168 U. S. 445, 42 L. Ed. 537;
Niles-Bement Pond Co. v. Iron Moulders Union, 254 U. S. 77, 65 L. Ed. 145;
Steele v. Culver, 211 U. S. 29, 53 L. Ed. 74.

Where diversity of citizenship is the sole ground of jurisdiction, parties will be aligned in accordance with their real interest in the controversy, to determine whether there is such diversity, and if no diversity exists the action will be dismissed.

(6 C. C. A.) Berg v. Merchant, 15 Fed. (2d) 990.

The essential question is whether the complainant is seeking to enforce, in whole or in part, a right of the defendant sought to be realigned as a complainant; and, if so, whether such defendant is an indispensable party so as of necessity to destroy the "diversity of citizenship."

(6 C. C. A.) Detroit T. & M. Co. v. Mason Contractors Assn., 48 Fed. (2d) 731.

The sole purpose of the accounting feature of the suit is to require the individual defendants to pay back money paid to them by the corporations for services, expenses, etc. It is a claim on behalf of the corporations alone, and they alone would be directely interested in the recovery. The incidental interest of a potential stockholder in the ultimate result is not regarded.

The interests of the corporation and the interests of Johnson and Pendleton are alleged by the bill to be antagonistic (Bill of Complaint, Vol. 1, p. 4).

That is obviously true. Hence the accounting sought is essentially a claim on behalf of the corporations against the individual defendants, all citizens of Kentucky.

In Geneva Cooperage Co. v. Karpen & Bros., 238 U. S. 254, 59 L. Ed. 1295, it was held:

> "The jurisdiction of the federal courts as limited and fixed by Congress cannot be enlarged by uniting in a single suit, under the rule governing the joinder of causes of action in suits in equity, causes of action of which the court is without jurisdiction with one of which it has jurisdiction."

In Blacklok et al. v. Small et al., 127 U. S. 96, 32 L. Ed. 70, it was held:

> "The Circuit Court of the United States has no jurisdiction of a suit which is substantially by and for the benefit of one of the defendants, named therein, who was at the time of the commencement of the suit, and has since continued to be, a citizen of the same state with another defendant therein, against whom the substantial relief in the action is claimed."

In Mass v. Furlong (6 C. C. A.), 93 Fed. (2d) 182, it is said:

> "Jurisdiction cannot be enlarged by uniting in one suit a cause of action over which we assume that the District Court has jurisdiction with another over which it had not." Citing:
>
> Geneva Fur Co. v. Karpen & Bros., 238 U. S. 254, 59 L. Ed. 1295.

See, also:

Goss v. Henry McCleary Timber Co., 82 Fed. (2d) 477;

Lockett v. Delpark, Inc., 270 U. S. 495, 70 L. Ed. 703.

In Hurn v. Oursler, 298 U. S. 238, 77 L. Ed. 1148, it was said:

> "But the rule does not go so far as to permit a federal court to assume jurisdiction of a separate and

distinct nonfederal cause of action because it is joined in the same complaint with a federal cause of action."

What the plaintiffs ask is that the Johnsons and Pendleton, citizens of Kentucky, be required to pay to the Kentucky corporation certain sums of money claimed to have been improperly collected from the corporations over a period of several years. That is a controversy between citizens of Kentucky alone; and the plaintiffs could not, in any event, collect or claim any money that might be held to be due the corporations. The interests of the corporations and of the individuals are adverse and antagonistic, and they must necessarily be aligned in opposition. Clearly, in such a situation, the diversity of citizenship essential to jurisdiction is destroyed.

In the case of Hawes v. Contra Costa Water Co., 104 U. S. 450, 26 L. Ed. 827, a bill was held bad for want of equity because the plaintiffs had not exhausted their opportunity for self-help within the corporation. That case gave the subject profound consideration and out of it grew Equity Rule 94, which was the same as the present Rule 27, with the addition of the words at the end, "or the reasons for not making such effort."

The present bill does not allege any facts to excuse the holders of one-half the stock of a corporation from making an effort to get relief from the directors or stockholders. The proof shows that they refused to enter a meeting of the parties interested, or to discuss any business until their contract was changed.

It will be noted that the allegations of the bill (Vol. 1, pp. 3-5) are almost precisely the same as appeared in the Venner case, which were held inadequate in a suit by a minority stockholder. Turning to that case we find:

In Venner v. Great Northern Ry. Company and James J. Hill, 209 U. S. 24, 52 L. Ed. 666, a suit was filed by

Venner, a minority stockholder, against the corporation and Hill, to compel Hill, who was a director and president of the corporation, to account to the corporation for an alleged profit made by him on stock sold to the company. The lower court aligned the corporation with the plaintiff and dismissed for want of jurisdiction, both the corporation and Hill being residents of Minnesota.

The Court recognized the rule that the arrangement of the parties should be made so as to align them according to their interest and attitude to the controversy, and then to determine the question of jurisdiction in view of the realignment. The Court said:

> "It would doubtless be for the financial interest of the defendant railroad that the plaintiff should prevail. But that is not enough. Both defendants unite, as sufficiently appears by the petition and other proceedings, in 'resisting the plaintiff's claim of illegality and fraud.' They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant. Davenport v. Dows, 18 Wall. 626, 21 L. Ed. 938; Central R. Co. v. Mills, 113 U. S. 249, 28 L. Ed. 949, 5 Sup. Ct. Rep. 456; East Tennessee V. & G. R. Co. v. Grayson, 119 U. S. 240, 30 L. Ed. 382, 7 Sup. Ct. Rep. 190; Doctor v. Harrington, 196 U. S. 579, 49 L. Ed. 606, 25 Sup. Ct. Rep. 355; Groel v. United Electric Co., 132 Fed. 252; and see Chicago v. Mills, supra."

The distinction is in this fact:

A minority stockholder would be wholly defeated where the corporation refused to repudiate the purchase, and, the corporation itself being a wrongdoer in the matter, it could not be aligned on the other side. In this case the

plaintiffs claim to own one-half of the stock of the corporation, and do not charge or claim that the corporation itself did any wrong or engaged in any conduct that is made the basis of the claim against the individuals, or that holders of half the stock could not get relief, if they asserted themselves.

The same distinction was presented in the Harrington case, which was followed.

But the case of Venner v. G. N. Ry. Co. went further and affirmed the judgment of dismissal on another ground. Venner had not shown by proper averments:

(1) That he was a stockholder when the assailed transaction took place; and

(2) That he had made any effort to comply with Equity Rule 24 by setting forth with particularity the efforts he had made to secure action by the management, or, if otherwise, the causes of his failure to obtain such action.

He did allege that Hill had absolute control of the whole board of directors, and stated about the same conclusions stated in the bill in this case.

According to the rule of Hawes v. Contra Costa Water Co., 104 U. S. 450, 26 L. Ed. 827, and the cases, supra, the bill is bad for want of equity.

Equity Rule 27 has now been superseded by Rule 23 (b), which is as follows:

> "Rule 23 (b). In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complainant shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains of law, and (2) that the action is not a collusive one to confer on a court of the

United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complainant shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees, and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action, or the reasons for not making such effort."

In Hamer v. New York Rys. Co., 244 U. S. 266, 61 L. Ed. 1125, the suit was dismissed for lack of jurisdiction after aligning a trust company with the plaintiffs. The distinctions in the cases are clearly noted. Says the Court:

"It is not contended that this refusal to sue makes the Trust Company an adversary, to be classed for purpose of jurisdiction with the real defendants—as in those cases where the refusal to sue was part of a fraudulent participation in the wrongdoing, and where the trustee or corporation in effect ranged itself in opposition to the relief sought."

Venner v. Great Northern Ry. Co., 209 U. S. 24, 52 L. Ed. 666;
Doctor v. Harrington, 196 U. S. 579, 49 L. Ed. 606;
Kelly v. Miss. R. C. Co., 175 Fed. 492;
Groel v. United Elect. Co., 132 Fed. 252.

"The Trust Company having, as we have shown, a real interest in the controversy, which makes it a necessary party to the suit, must be aligned as a party plaintiff where its interest lies."

Blacklok v. Small, 127 U. S. 96, 32 L. Ed. 70;
Harter Tp. v. Kernochan, 103 U. S. 562, 26 L. Ed. 411;
Pacific R. Co. v. Ketchum, 101 U. S. 289, 25 L. Ed. 932;
Allen-West Com. Co. v. Brashear, 176 Fed. 119;
Shipp v. Williams, 62 Fed. 4.

On the face of the bill it is very clear that no facts are alleged to bring the case within the jurisdiction of the

Court. On the facts of the record, there is a failure to prove that the plaintiffs are stockholders in any of the corporations. As a matter of fact, they were not at any time stockholders. The only rights they had were defined by the executory contract of February 18, 1931, under which they could have become stockholders by conforming to its terms. But when they renounced that contract, they were left without any cause of action of any kind, or for any purpose, and without a right to acquire stock, or to obtain relief at law or in equity.

V.

BLACK GOLD MINING COMPANY STOCK.

The petitioners argue that the refusal of the lower courts to confiscate the stock of W. E. Davis, E. J. Davis and J. E. Johnson, Sr., in Black Gold Mining Company was probably contrary to decisions of this Court. There is no decision of this or any other court in this country that petitioners have or ought to have any claim to the stock of Black Gold Mining Company.

The Black Gold was not financed in any way by the Blue Grass. Months after it was in operation, and after the contract of February 18, 1931, was made, the companies had some mutual charges and credits growing out of operations for the convenience of the parties. The accounts were never large and, when the balance was in favor of Blue Grass, legal interest was paid (Record, Vol. 4, p. 1275, Lavender). When Mr. Garth and Mr. Pendleton did work for Black Gold, they were paid by Black Gold (Vol. 5, p. 1711). The claim of petitioners to the stock of Black Gold and Jeda is utterly unsupported by any fact and neither E. J. Davis nor W. E. Davis are parties, although they own all the stock except that held by Mr. Johnson. The claim is purely fictitious, and the whole argument irrelevant for lack of factual support.

The petitioners have been unjustly enriched at the expense of respondents and, having been so successful in that demand, they look with covetous eyes upon the Black Gold Mining Company and Jeda Coal Company and seek to appropriate their properties.

Wherefore, it is respectfully submitted, the petition for a writ of certiorari should be denied.

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Ashland, Kentucky,
July 6, 1942.